Zacks Small-Cap Research

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www.zacks.com

111 North Canal Street • Chicago, IL 60606

The First Marblehead Corporation (FMD-NYSE)

FMD: Fourth Quarter Results - NEUTRAL

Current Recommendation	**Neutral**
Prior Recommendation	N/A
Date of Last Change	06/10/2010
Current Price (08/31/11)	$1.40
Six- Month Target Price	**$1.75**

OUTLOOK

Our recommendation on The First Marblehead Corporation (FMD) is Neutral. FMD is in the initial stages of a turnaround. It has rolled out its new partnered lending program with two lenders, Sun Trust Bank and Kinecta Federal Credit Union, has added tuition payment services to its product line-up through the recent acquisition of TMS, and recently began using its Union Federal Savings Bank (UFSB) subsidiary to originate private education loans. That said, we believe that any meaningful pickup in revenues will be dependent upon a significant ramp-up in partnered lending and UFSB loan origination and the re-entry of FMD into the securitization market, in which it has not participated since September 2007. Until that time, FMD continues to lose money, though at a decelerating pace, with our diluted loss per share estimate at $0.52 in fiscal 2012, an improvement over fiscal 2011's loss per share of $0.87 before a nonoperating gain. Fortunately, FMD has strengthened its balance sheet, and has an available cash cushion of about $214 million at present, though it is burning cash at the rate of $11-12 million per quarter.

SUMMARY DATA

52-Week High	**$2.54**
52-Week Low	**$1.21**
One-Year Return (%)	**-33.01**
Beta	**2.14**
Average Daily Volume (sh)	**248,000**
Shares Outstanding (mil)	**101**
Market Capitalization ($mil)	**$142**
Short Interest Ratio (days)	**17.79**
Institutional Ownership (%)	**39**
Insider Ownership (%)	**31**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2011 Estimate	**N/A**
P/E using 2012 Estimate	**N/A**
Zacks Rank	**3**

Risk Level	**Above Average**
Type of Stock	**N/A**
Industry	**Fin-Cons Loans**
Zacks Rank in Industry	**11 of 11**

ZACKS ESTIMATES

Net Revenue*
(in millions of $)

	Q1 (Sep)	Q2 (Dec)	Q3 (Mar)	Q4 (Jun)	Year (Jun)
2009	(84.9)A	(86.1)A	(130.6)A	11.6A	(290.0)A
2010	13.5A	10.1A	(16.8)A	9.5A	16.3A
2011	5.1A	9.5A	(14.6)A	7.5A	7.5A
2012					59.9E

Earnings per Share*
(EPS is operating earnings before nonrecurring items)

	Q1 (Sep)	Q2 (Dec)	Q3 (Mar)	Q4 (Jun)	Year (Jun)
2009	$(0.94)A	$(0.94)A	$(1.42)A	$(0.36)A	$(3.66)A
2010	$(0.95)A	$(0.12)A	$(0.30)A	$(0.10)A	$(1.46)A
2011	$(0.16)A	$(0.10)A	$(0.41)A	$(0.19)A	$(0.87)A
2012					$(0.52)E

*Education finance only in 2011-12
Quarterly EPS may not add to total dues to changes in shares outstanding

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FOURTH QUARTER

On August 30, 2011, the Company reported its fiscal fourth quarter results for the period ending June 30, 2011. For the quarter, FMD recorded a net loss from education financing of $19.5 million, or a diluted loss per share of $0.19. The total net loss, including the securitization trusts net loss of $64.5 million, was $83.8 million, or a $0.83 loss per diluted share.

Our fourth quarter loss estimate for the education financing segment was $13.4 million, or a loss of $0.13 per diluted share. The primary reasons for the shortfall from our estimate include: (1) administrative and other fees that were $1.8 million lower than our $11.5 million estimate, reflecting seasonally weaker revenues at TMS as typically occurs in the April-June quarter and (2) trust updates, usually very volatile and difficult to predict, had a loss of $2.4 million, $3.5 million below our estimate of a $1.1 million gain.

At this point, we are retaining our education financing diluted per share loss estimate of $0.52 for fiscal 2012, ending June 30, 2012. This compares to an education financing net loss of $87.4 million (excluding a $6 million of nonoperating gain) in fiscal 2011, or a $0.87 loss per diluted share. While revenues at TMS will be a bit lower than we had estimated due to the sale of a portfolio of contracts to Nelnet on June 30, 2011, we believe that results at USFB may be stronger than we had anticipated due to better acceptance of its Monogram-based student loan program.

Below we discuss 2011 fiscal fourth quarter results in more depth.

Business Review

FMD has had an auspicious launch to its first peak origination student loan season since the beginning of the credit crisis in 2007. Including the Monogram-based loan programs at Sun Trust and Kinecta that began in July and September 2010, respectively, as well as at Union Federal Savings Bank (UFSB), which began on July 1, 2011, the Company has processed over 40,000 private student loan applications representing $430 million in loans, of which it has approved $107 million, or one-quarter of the $430 million total. Of the total $107 million amount approved, $23 million has been booked to date.

These metrics demonstrate that loan demand is quite strong and that FMD is accepting only the cream of the crop, the top 25% of all loans submitted. This is further borne out by the credit quality statistics of the loans that have been approved: a weighted-average credit score of 762; 88% are cosigned, 64% are in immediate repayment; 67% have repayment terms of 10 years or less; weighted average interests rates of 6.64% for variable-rate loans and of 8.95% for fixed-rate loans; and 75% of loans are fixed rate, generating a higher margin for FMD.

While the Sun Trust and Kinecta loan programs contribute 310-490 basis points of revenue per loan, we believe the margins are much higher for UFSB. At UFSB, we estimate that the average margin for variable-rate loans is approximately 6% and for fixed rate loans is about 8-8 ¼%, using 65-75 basis points in costs, consisting of deposit funding costs of 50-60 basis points and 10-15 basis points for the cash participation reserve account.

Clearly, the UFSB loans are more profitable for FMD than either the Sun Trust or Kinecta loan programs. However, lending capacity at UFSB is limited to $30 million given current regulatory capital constraints, far below the capacity of $200 million at Sun Trust and of $75 million at Kinecta.

There are a couple of options available to FMD to increase lending capacity at UFSB. First, FMD could downstream cash from the holding company as a capital contribution to UFSB. With a larger capital base, UFSB could lend more.

In addition, FMD has been exploring the establishment of a warehouse line of credit at an investment bank, which could house UFSB's education loans until they are ready to be securitized. This would free up capital at UFSB since the loans would be sold to an investment bank.

The investment bank would underwrite the securitization and FMD would earn structural and advisory fees for structuring the transaction. While we sense nothing is imminent, once loan volume at UFSB reaches $50-100 million, it might make sense financially to go the securitization route, recognizing that FMD has been out of the securitization market since the fall of 2007 and initial terms could be somewhat onerous until FMD regains acceptance in this market.

Future growth prospects for the Monogram loan program appear bright. FMD recently added nine people to its sales staff and now has a 16-member sales team that has visited over 1,100 schools across the country. FMD currently has Monogram lending programs at 300 schools in 30 states, a 50% increase from 200 schools at the end of the previous quarter in March. This is expected to grow significantly in 2012 due to the addition of UFSB, though it may require a bit of time for UFSB's loan products to gain market acceptance. Moreover, as these Monogram lending programs mature, the likelihood of repeat business increases.

From a macro standpoint, pressure on the US government's budget could cause a reduction in federal student loan programs, which could benefit private student lenders, including First Marblehead. In addition, as regional banks enter the private student loan sector or expand beyond their lending footprints beyond their territories to enhance diversification, FMD's high-quality Monogram private student education loans could be a good fit.

At TMS, on June 30, FMD announced the completion of the $6.9 million sale to Nelnet of a portfolio of contracts with 377 lower cost private, predominantly faith-based primary and secondary schools, though TMS will continue to service these schools through the upcoming school year. Of the $6.9 million, $5.4 million was received immediately, with $1.5 million to be received in May 2012 provided that certain conditions are met. While this portfolio accounted for 18% of TMS's revenue in calendar-year 2010, it represented a much higher proportion of contracts at 33% of the total. This sale rids TMS of a less lucrative business and frees up resources that TMS can more profitably devote to higher margin opportunities through the build-out of complementary products and service lines.

As a result of the TMS contract sale to Nelnet sale, $6.7 million of goodwill and intangible assets were removed from FMD's balance sheet, leaving a balance of $42.6 million at June 30, 2011. In addition, revenues from TMS will be reduced to an estimated $25-28 million in fiscal 2012, compared to an estimated run rate of $27 million in fiscal 2011 ($14 million prior to acquisition and $13 million for the six months ending June 30, 2011). For the fiscal year ending June 30, 2011, TMS processed $4 billion in tuition payments, a year-over-year increase of 8.1%, for 343,000 students at 770 schools nationally.

Financial Review

On August 30, 2011, the Company reported its fiscal fourth quarter results for the period ending June 30, 2011. For the quarter, FMD recorded a net loss from education financing of $19.5 million, or a diluted loss per share of $0.19. The total net loss, including the securitization trusts net loss of $64.5 million, was $83.8 million, or a $0.83 loss per diluted share.

Education financing results included the impact of the December 31, 2010 acquisition of TMS. TMS added $5.9 million in net revenue in the fiscal fourth quarter, down from $7.1 million in the third quarter, as revenues are typically lowest during this quarter due to seasonal fluctuations in business. TMS was cash flow positive during the quarter, generating $0.6 million of cash flow after capital expenditures.

- Education financing net revenue was $7.5 million, primarily reflecting administrative and other fees of $9.5 million (including those of TMS at $5.9 million), partly offset by a $2.4 million loss from additional structural advisory fee and residual trust updates.

- Fiscal fourth quarter education financing non-interest expense was $26.9 million, down $0.3 million sequentially from the $27.2 million posted in the fiscal third quarter, in part reflecting lower occupancy costs, stemming from renegotiated leases and a 35,000

square-foot reduction in office space, which will contribute to a $0.9 million decline in occupancy expense in fiscal 2012.

- At June 30, 2011, education financing's total assets were $507.6 million and its stockholders' equity was $257.3 million.

- At June 30, 2011, the Company recorded $267.4 million in cash, cash equivalents, and short-term investments, down $11.3 million at the end of March 2010. Of this amount, about $53.8 million was located at Union Federal Savings Bank, with the $213.6 million balance available to FMD for other corporate purposes.

- Overall, net operating cash usage decreased by $2.5 million sequentially, falling to $10.6 million in 2011's fiscal fourth quarter from $13.1 million for the quarter ended March 31, 2011, the lowest quarterly amount for the 2011 fiscal year.

- As of the earnings release date, the Company was on the lender list of over 300 colleges and universities across the nation, up 50% from 200 at the end of the last quarter.

- FMD began originating Monogram-based private student loans at its UFSB subsidiary on July 1, 2011, the first day of the 2012 fiscal year.

For the fiscal fourth quarter, the securitization trusts reported a net loss of $64.5 million, or a $0.64 loss per diluted share. Total net revenue was a negative $53.4 million, as $61.9 million of net interest income was more than offset by a $115.7 million provision for loan losses, which increased $42.0 million sequentially, or 57%, from the March 2011 quarter and matched the level of net charge-offs during the quarter. In addition, general and administrative expenses were $11.1 million.

Net income from the GATE Trusts, in which FMD owns 100% of the residual interests, for the three and twelve month periods ended June 30, 2011 was $1.2 million, or $0.01 per share, and $6.1 million, or $0.06 per share, respectively.

OVERVIEW

The First Marblehead Corporation (FMD) provides student loan services to financial and education institutions throughout the United States. These services typically consist of helping these institutions design, originate, manage, and finance private education loan programs that further their strategic and financial goals, while also complying with the loan criteria they have established.

FMD offers these services under the Monogram® platform (Monogram), a new product for FMD that was developed over the last few years. Monogram utilizes FMD's proprietary credit risk analytics models, which are based upon data gathered by FMD over 20 years and among the most sophisticated in the industry. Through the partnered lending program based upon Monogram, FMD receives service fees, as well as a portion of the net interest income generated portfolio of program loans for which they provide credit enhancement

Currently, FMD has two clients using Monogram: Sun Trust Bank, headquartered in Atlanta and serving the Southeast and mid-Atlantic regions, with more than $170 billion in assets; and Kinecta Federal Credit Union, a California-based federal credit union with over $3.5 billion in assets. Program size is $200 million for Sun Trust and $75 million for Kinecta, with both programs having initial two-year terms that are expected to run through late 2012.

Other businesses of FMD include the administration of the National Collegiate Student Loan Trusts (NCSLT Trusts), in which FMD has no ownership interests (their residual interests were sold to a third

party in 2009), and the administration of certain other loan trusts and portfolios, for which FMD receives a fee of 0.05-0.20% of the principal loan balance.

In addition, with the December 2010 purchase of Tuition Management Systems (TMS) for $47 million, FMD has added a complementary fee-for-service business to its line-up. TMS, one of the nation's largest providers of outsourced tuition planning, billing, counseling, and payment technology services for colleges, universities, and elementary and secondary schools, operates in 47 states and now serves over 770 school clients, including such prestigious institutions as Duke University, Boston College, University of Chicago, MIT, and Carnegie Mellon. TMS is expected by FMD to add approximately $25-28 million of total revenues in fiscal 2012, as well as be earnings accretive.

FMD also owns a small federally chartered thrift, Union Federal Savings Bank of New Providence, Rhode Island (acquired in November 2006), that offers residential and commercial mortgage loans, and retail savings, money market and time deposit products. FMD had been exploring strategic alternatives for this business, but has retained Union Federal as a vehicle for originating Monogram-based private education loans beginning July 1, 2011.

Financial statements were considerably altered with the beginning of the fiscal 2011 year (ending June 30, 2011), following the adoption of new accounting standards, which required the consolidation of 14 securitizations trusts that had previously been accounted for off balance sheet. Thus, $8.2 billion of securitized loan receivables from the trusts were added to FMD's balance sheet, along with $9.0 billion of nonrecourse debt issued by the trusts. This occurred even though FMD has no ownership interest in, or liability or responsibility for the loans and debt of 11 of these trusts (FMD does have an ownership interest in a small $300 million portfolio of loans, related to the Guaranteed Access to Education—GATE—Trusts).

Because of this change, FMD now reports two business segments: education financing, which encompasses the fee-for-service operations of the Company, as well as Union Federal Savings Bank; and securitization trusts, which include the 11 NCSLT Trusts and 3 GATE Trusts. The results for the education financing segment are generally comparable to the financial reporting used by the Company prior to this fiscal year.

VALUATION

FMD's stock valuation metrics are depressed. Although FMD is in the initial stages of a turnaround and we are encouraged by the progress made to date, the outlook remains somewhat murky. Moreover, FMD continues to lose money, though at a decelerating pace, with our diluted loss per share estimate at $0.52 in fiscal 2012, an improvement over fiscal 2011's loss per share of $0.87 before a nonoperating gain of $0.06 per share.

This is reflected in FMD's stock price. FMD shares have declined 35.5% year to date, compared to a median decrease of 4.2% for financial services companies in the Zacks small-cap index, as shown in the following table. The shares had been down over 44% when FMD hit a recent closing low of $1.21 on August 19 and 22, but have reversed part of that decline and are now trading at $1.40.

Turning to Price/Book Value, FMD is valued at 0.66X, well below the industry median of 1.42X. It is also below FMD's average Price/Book Value of 0.81X for the past year or so.

Applying the 0.81X ratio to our estimated book value for FMD six months out results in a price target of approximately $1.75. This is a bit above FMD's current stock price. Therefore, we recommend a Neutral on FMD shares.

Industry Comparables- Small-cap Financial Services

	Pr Chg YTD	Price / Earnings Ratios TTM* EPS	2011E	2012E	5-Yr Avg	Price/ Book	Return on Equity TTM*	5-Yr Avg	Return on Assets TTM*	5-Yr Avg	Div Yld
First Marblehead	**(35.5)**					**0.66**	**Neg**	**Neg**	**Neg**	**Neg**	**-----**
S&P 500	**6.8**	**18.3**	**14.0**	**12.9**	**17.9**	**3.7**	**26.1**		**8.96**		**1.8**
Median	**(4.2)**	**11.0**	**9.4**	**8.2**	**10.8**	**1.42**	**7.8**	**12.0**	**1.03**	**2.03**	**-----**
Average	(5.2)	15.0	9.6	7.3	19.4	1.9	(7.4)	1.4	(3.43)	1.82	1.5
High	48.2	31.1	14.5	9.2	64.7	4.9	22.2	32.6	12.91	12.56	7.3
Low	(54.2)	6.7	3.3	3.4	8.5	0.4	(114.3)	(65.2)	(75.42)	(13.63)	-----

*Trailing twelve months

The First Marblehead Corporation

Income Statement and Balance Sheet

(Dollars in millions, except per share data)

	06/06	06/07	06/08	06/09	06/10	06/11 P	06/12 E
Net interest income	5.5	9.4	25.6	25.1	9.9	0.7	4.6
Non-interest revenue	566.1	871.3	(54.0)	(315.1)	6.4	6.8	55.3
Total net revenue	571.6	880.7	(28.4)	(290.0)	16.3	7.5	59.9
Loan loss provision	0.0	0.0	0.0	0.0	0.0	0.3	0.1
Non-interest expense	187.8	253.0	358.5	260.8	232.1	93.5	110.2
Income tax expense (credit)	147.8	256.4	(151.8)	(187.8)	(70.3)	1.1	2.5
Education financing net income before NRI	**236.0**	**371.3**	**(235.1)**	**(363.0)**	**(145.5)**	**(87.4)**	**(52.9)**
Securitization trusts net income & eliminations	0.0	0.0	0.0	0.0	0.0	(140.2)	(144.0)
Zacks adjusted net income before NRI	236.0	371.3	(235.1)	(363.0)	(145.5)	(227.6)	(196.9)
GAAP net income	236.0	371.3	(235.1)	(363.0)	(145.5)	(221.6)	(196.9)
Education financing EPS	**2.45**	**3.92**	**(2.46)**	**(3.66)**	**(1.46)**	**(0.87)**	**(0.52)**
Reported EPS	2.45	3.92	(2.46)	(3.66)	(1.46)	(2.20)	(1.94)
Dividends per share	0.32	0.58	0.40	0.00	0.00	0.00	0.00
Cash & short-term investments	143.0	234.9	221.1	181.5	385.5	278.4	226.4
Restricted cash & GICs	0.0	0.0	0.0	0.0	1.0	124.7	100.0
Loans	0.0	37.1	508.1	360.5	113.6	6.4	17.0
Receivables	551.6	809.7	411.2	233.9	73.3	8.2	30.0
Other assets	75.7	132.8	60.5	45.4	60.0	89.9	70.5
Total education financing assets	**770.3**	**1,214.5**	**1,200.9**	**821.3**	**633.4**	507.6	443.9
Securitization trusts assets & eliminations	0.0	0.0	0.0	0.0	0.0	7,144.3	6,504.4
Total assets	770.3	1,214.5	1,200.9	821.3	633.4	7,651.9	6,948.3
Deposits	0.0	53.5	244.1	154.5	108.7	60.5	60.7
Restricted funds due to clients	0.0	0.0	0.0	0.0	0.0	121.9	100.0
Short-term borrowings	0.0	0.0	242.9	230.1	218.1	0.0	0.0
Long-term borrowings	8.8	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities	185.3	318.4	76.3	31.2	36.8	67.9	78.8
Education financing shareholders' equity	576.2	842.6	637.6	405.5	269.8	257.3	204.4
Education financing liabilities and equity	**770.3**	**1,214.5**	**1,200.9**	**821.3**	**633.4**	507.6	443.9
Securitization trusts liabilities & eliminations	0.0	0.0	0.0	0.0	0.0	8,281.7	7,785.7
Securitization trusts equity & eliminations	0.0	0.0	0.0	0.0	0.0	(1,137.4)	(1,281.3)
Total liabilities and equity	770.3	1,214.5	1,200.9	821.3	633.4	7,651.9	6,948.3

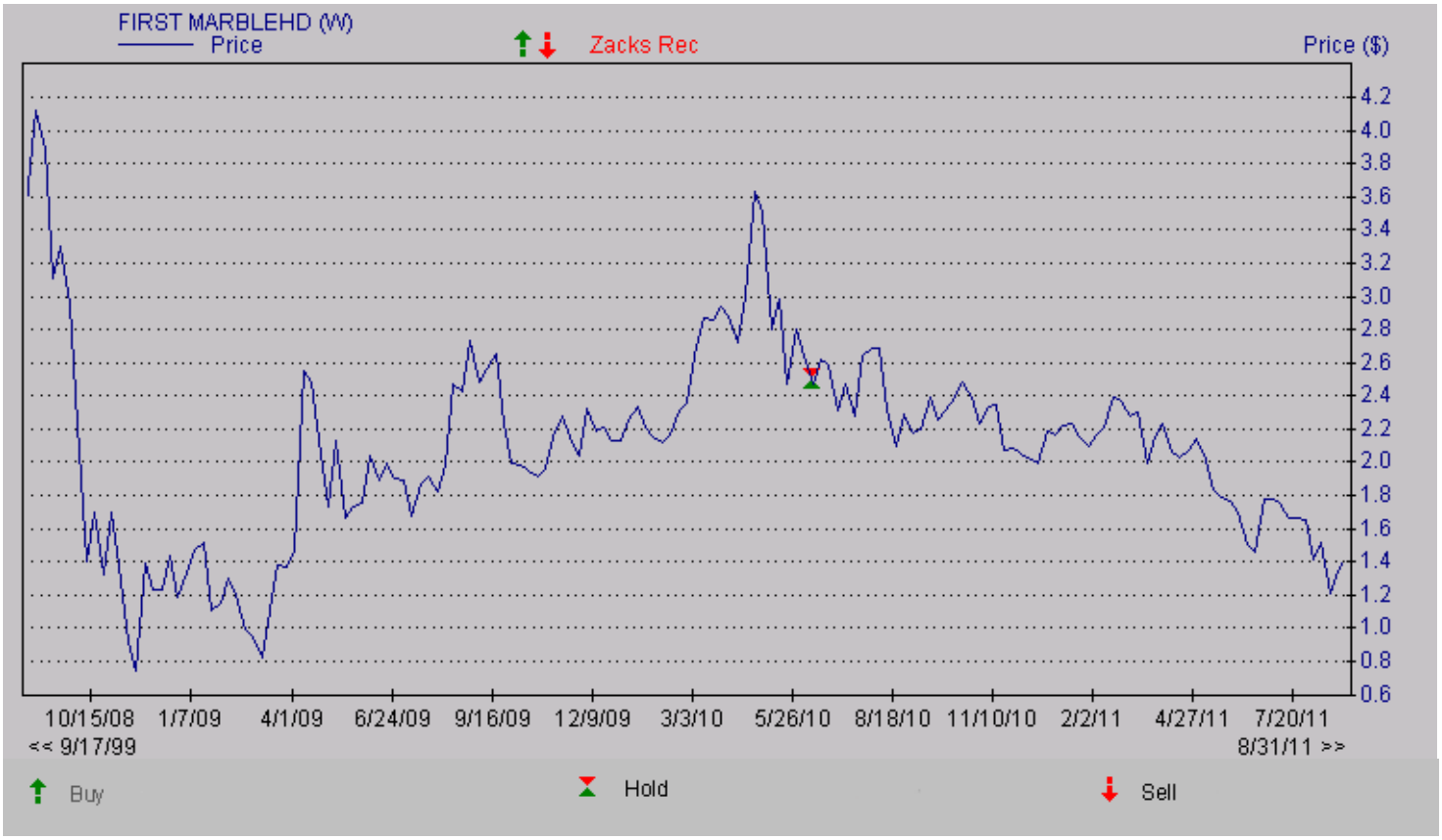
The First Marblehead Corporation

Income Statement and Balance Sheet

(Dollars in millions, except per share data)

	2010				2011			
	Q1 A	**Q2 A**	**Q3 A**	**Q4 A**	**Q1 A**	**Q2 A**	**Q3 A**	**Q4 A**
Net interest income	4.4	1.5	0.7	3.3	0.1	0.2	0.4	0.0
Non-interest revenue	9.1	8.6	(17.5)	6.2	5.0	9.3	(15.0)	7.5
Total net revenue	13.5	10.1	(16.8)	9.5	5.1	9.5	(14.6)	7.5
Loan loss provision	(0.1)	0.0	0.0	0.0	0.1	0.2	0.0	0.0
Non-interest expense	150.3	31.2	28.0	22.7	20.0	19.5	27.2	26.9
Income tax expense (credit)	(42.6)	(9.4)	(15.4)	(2.8)	1.1	(0.0)	(0.1)	0.1
Education financing net income before NRI	**(94.1)**	**(11.7)**	**(29.4)**	**(10.4)**	**(16.1)**	**(10.2)**	**(41.7)**	**(19.5)**
Securitization trusts net income & eliminations	0.0	0.0	0.0	0.0	(48.9)	(29.3)	2.4	(64.3)
Zacks adjusted net income before NRI	(94.1)	(11.7)	(29.4)	(10.4)	(65.0)	(39.5)	(39.3)	(83.8)
GAAP net income	(94.1)	(11.7)	(29.4)	(10.4)	(65.0)	(33.4)	(39.3)	(83.8)
Education financing EPS	**(0.95)**	**(0.12)**	**(0.30)**	**(0.10)**	**(0.16)**	**(0.10)**	**(0.41)**	**(0.19)**
Reported EPS	(0.95)	(0.12)	(0.30)	(0.10)	(0.64)	(0.33)	(0.39)	(0.83)
Dividends per share	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Cash & short-term investments	187.7	456.0	430.0	385.5	332.9	297.8	282.3	278.4
Restricted cash & GICs	0.0	0.0	0.0	1.0	0.0	147.0	97.4	124.7
Loans	241.3	111.4	108.1	113.6	8.6	8.0	6.9	6.4
Receivables	230.0	75.0	56.0	73.3	34.1	14.6	32.0	8.2
Other assets	77.7	65.6	73.5	60.0	50.0	114.1	72.8	89.9
Total education financing assets	**736.7**	**708.0**	**667.6**	**633.4**	**425.6**	**581.5**	**491.4**	507.6
Securitization trusts assets & eliminations	0.0	0.0	0.0	0.0	7,824.8	7,504.1	7,347.8	7,144.3
Total assets	736.7	708.0	667.6	633.4	8,250.4	8,085.6	7,839.2	7,651.9
Deposits	156.4	145.0	127.4	108.7	79.5	55.9	57.3	60.5
Restricted funds due to clients	0.0	0.0	0.0	0.0	0.0	147.0	94.7	121.9
Short-term borrowings	229.5	228.9	227.9	218.1	0.0	0.0	0.0	0.0
Long-term borrowings	0.0	0.0	0.0	0.0	0.0	(0.0)	0.0	0.0
Other liabilities	38.7	32.3	38.3	36.8	28.6	64.1	65.4	67.9
Education financing shareholders' equity	312.1	301.8	274.0	269.8	317.5	314.5	274.0	257.3
Education financing liabilities and equity	**736.7**	**708.0**	**667.6**	**633.4**	**425.6**	**581.5**	**491.4**	507.6
Securitization trusts liabilities & eliminations	0.0	0.0	0.0	0.0	8,869.6	8,578.2	8,419.6	8,281.7
Securitization trusts equity & eliminations	0.0	(0.0)	(0.0)	0.0	(1,044.8)	(1,074.1)	(1,071.8)	(1,137.4)
Total liabilities and equity	736.7	708.0	667.6	633.4	8,250.4	8,085.6	7,839.2	7,651.9

HISTORICAL ZACKS RECOMMENDATIONS



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